

## **REPORT OF THE AUDITOR-GENERAL TO THE PROVINCIAL LEGISLATURE AND THE COUNCIL ON VHEMBE DISTRICT MUNICIPALITY**

### **REPORT ON THE FINANCIAL STATEMENTS**

#### **Introduction**

1. I have audited the accompanying financial statements of the Vhembe District Municipality, which comprise the statement of financial position as at 30 June 2011, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages xx to xx

#### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), and for such internal control as management determines necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditor-General's responsibility**

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996) section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1111 of 2010* issued in *Government Gazette 33872 of 15 December 2010*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

### **Basis for qualified opinion**

#### **Property, plant and equipment (PPE)**

7. The Standards of Generally Recognised Accounting Practice, GRAP 17, *PPE* requires that an item of PPE should be separated into parts or components, when those parts or components are significant in relation to the total cost of the item. It is further required that each of these individual parts or components be depreciated separately. Included in PPE in the financial statements is water infrastructure assets with a gross carrying amount of R533 727 267 (2010: R293 737 574) which the municipality did not identify and separate into parts or components as per the above requirement.
8. Due to the nature of these assets, I was unable to confirm or verify by alternative means the value of water infrastructure assets included in the total PPE balance in the financial statements amounting to R1 639 799 581 (2010: R1 259 515 959) and the related accumulated depreciation and depreciation amounts of R5 220 603 (2010: R5 103 254) as disclosed in note 2 to the financial statements. I have also identified that the corresponding figures for PPE differs from the prior year's closing balance by R129 766 239. Consequently, I did not obtain sufficient appropriate evidence to satisfy myself as to the valuation of PPE.
9. The municipality reviewed the useful lives of PPE at the reporting date in accordance with the Standard of Generally Recognised Accounting Practice, GRAP 17, *PPE*. The value of assets determined through the review of useful lives, as recorded in the financial records, differed with the values as per the expert's valuation report by R24 869 016. Consequently PPE, depreciation and fair value adjustment is overstated by this difference.

#### **Inventory**

10. I was unable to determine the accuracy of the water inventory due to the incorrect costing principles applied in the calculation. The municipality used the closing inventory production instead of the total production for the year in their calculations. Consequently, the inventory amounting to R88 432 567 (2010: R88 987 405) and operating surplus will be overstated as a result of this error, the exact value of the error could not be quantified.

## **Revenue**

11. There was no system of control over water revenue on which I could rely on for the purpose of my audit, and there were no satisfactory alternative procedures that I could perform to obtain reasonable assurance that all water revenue was properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of water revenue recognised at R70 538 059 (2010: R77 097 642), as disclosed in note 12 to the financial statements and the related receivable balance amounting to R45 963 555 (2010: R15 698 046), as disclosed in note 20 to the financial statements. I was unable to determine the impact of this on the valuation of accounts receivable.

## **Distribution losses**

12. Section 125 (2) (d) (i) of the MFMA requires that the notes to the annual financial statements of a municipality must disclose the particulars of any material losses. The municipality did not disclose the water distribution losses as required by the MFMA.

## **Commitments**

13. I identified contracts in the contract management system that was not included in disclosure note 32 to the financial statements and there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all commitments were properly recorded. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of commitments of R935 592 204 (2010: R430 062 556), as stated in note 32 to the financial statements.

## **Irregular expenditure**

14. Section 125(2)(d) of the MFMA, requires that the notes to the annual financial statements of a municipality must disclose the particulars of any material irregular expenditure. Awards amounting to R107 437 573 were made in contravention of the supply chain management requirements. The amount was not included in irregular expenditure, as disclosed in note 37 to the financial statements, resulting in irregular expenditure being understated by R107 437 573.

## **Opinion**

15. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Vhembe District Municipality for the year ended 30 June 2011, and its financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA standards of

GRAP) and in the manner required by the MFMA.

#### **Emphasis of matters**

I draw attention to the matters below. My opinion is not modified in respect of these matters:

#### **Restatement of corresponding figures**

16. As disclosed under note 39 to the financial statements, the corresponding figures for 30 June 2010 have been restated as a result of errors discovered during 2011 in the financial statements of the municipality at, and for the year ended, 30 June 2010.

#### **Fruitless and wasteful expenditure**

17. As disclosed under note 36 to the financial statements, Vhembe District Municipality incurred fruitless and wasteful expenditure of R419 101 as a result of interest and penalties charged due to late payments to suppliers as well as expenditure which could have been avoided.

#### **Additional matter**

I draw attention to the matter below. My opinion is not modified in respect of this matter:

#### **Unaudited supplementary schedules**

18. The supplementary information set out on pages X to X does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereof.

#### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

19. In accordance with the PAA and in terms of *General notice 1111 of 2010*, issued in Government Gazette 33872 of 15 December 2010, I include below my findings on the annual performance report as set out on pages X to X and material non-compliance with laws and regulations applicable to the municipality.

#### **Predetermined objectives**

#### **Usefulness of information**

20. The reported performance information was deficient in respect of the following criteria:
- Consistency: The reported objectives, indicators and targets are not consistent with the approved integrated development plan.

The following audit findings relate to the above criteria:

21. Satisfactory explanation was not given to the variances between the actual and planned performances in the annual report.

### **Compliance with laws and regulations**

#### **Annual financial statements, performance and annual report**

22. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements were identified by the auditors which were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

#### **Procurement and contract management**

23. Awards were made to providers without compiling specifications for the procurement of goods or services by the municipality's bid specification committee as per the requirement of Municipal Supply Chain Regulation, section 27(i)
24. The municipality did not sign written agreements with awarded service providers as per the requirements of Municipal Supply Chain Policy section 20(g)(i), section 116 of the MFMA and MFMA circular 25
25. Awards were made to service providers who are persons in service of other state institutions in contravention of the requirements of SCM regulations 44. Furthermore the service provider failed to declare that he/she is in the service of the state as required by SCM regulation 13(c).

#### **Expenditure management**

26. The accounting officer did not take effective and appropriate steps to prevent irregular expenditure, as per the requirements of section 62(1)(d) of the MFMA.
27. All payments due to creditors were not settled within 30 days from receipt of an invoice, as per the requirements of section 65(2)(e) of the MFMA.

#### **Revenue management**

28. Revenue received by the municipality was not always reconciled on at least, a weekly basis, as required by section 64(2)(h) of the MFMA.

#### **Asset management**

29. The accounting officer did not take all reasonable steps to ensure that the municipality had and maintained an effective system of internal control for assets (including an asset register reconciliation with general ledger) as required by section 63(2)(c) of the MFMA.

## **INTERNAL CONTROL**

30. In accordance with the PAA and in terms of General notice 1111 of 2010, issued in *Government Gazette 33872 of 15 December 2010*, I considered internal control relevant to my audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported below are limited to the significant deficiencies that resulted in the basis for qualified of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report

### ***Leadership***

- The accounting officer did not exercise oversight responsibility regarding financial and performance reporting and compliance and related internal controls.
- The accounting officer did not implement effective HR management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored.

### ***Financial and performance management***

- The chief financial officer did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting.
- The chief financial officer did not implement adequate controls over daily and monthly processing and reconciling of transactions.
- The chief financial officer did not prepare regular, accurate and complete financial reports that are supported and evidenced by reliable information.
- The chief financial officer did not review and monitor compliance with applicable laws and regulations.
- Management did not design and implement formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information.

## **Governance**

- There was no appropriate risk management activities to ensure that regular risk assessments, including consideration of IT risks and fraud prevention are conducted and that a risk strategy to address the risks is adequately monitored.

*Auditor-General*  
Polokwane

30 November 2011



AUDITOR-GENERAL  
SOUTH AFRICA

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